



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

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Dear _____ :

I am responding to a letter you sent to Charles Rettig, Commissioner, Internal Revenue Service and Eric, Hylton, Commissioner, Small Business and Self-Employed Division on July 5, 2020, about allowing small business pension plans and Keogh plans to engage in short sales of stock and about the applicable user fee should you apply for that capability.

While I cannot provide guidance with respect to specific investments permitted in retirement plans, I hope the following general information will be helpful. Please note that the following information pertains to Internal Revenue Code (Code) requirements. Title I of ERISA, administered by the Department of Labor, also provides rules regarding permissible investments and fiduciary responsibilities.

There is no list of approved investments for retirement plans for purposes of the Code; however, the Code does contain certain rules relating to plan investments.

Certain restrictions on investments apply to specific plan types. For example, Code section 401(a)(22) provides limits on the amount of employer securities certain plans may hold. In addition, in accordance with Code section 408(m) participant-directed accounts and IRAs may not invest in collectibles, such as art, antiques, gems, coins, or alcoholic beverages, and they may invest in certain precious metals only if they meet specific requirements.

There are also specific transactions between the plan and a "disqualified person" that (with some exemptions) are prohibited by law. A disqualified person includes, among others, an employer with employees covered by the plan, and the plan trustee. Engagement in a prohibited transaction can result in the imposition of an excise tax under Code section 4975.

In addition, the IRS has ruled that, under certain circumstances, the income of an exempt organization that is attributable to a short sale of publicly traded stock through a broker is not subject to the unrelated business income tax under section 511 of the Code. Section 511(a) imposes a tax on the unrelated business taxable income (“UBTI”) of retirement plans that are otherwise exempt from federal income taxation under Code section 501(a). Code section 512(a)(1) of the Code defines UBTI as gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain deductions which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in Code section 512(b). Section 512(b)(4) provides, in part, that UBTI includes certain income from “debt-financed property” as defined in Code section 514(b). In Rev. Rul. 95-8, 1995-4 I.R.B. 29, the IRS ruled that, under the facts of that ruling, income to a tax-exempt organization from a short sale was not subject to the tax on UBTI under Code section 511(a) because income generated by a short sale was not income from “debt-financed property” described in section 514.

Finally, we note that investments made in qualified plans are also subject to the exclusive benefit rule of Treasury Regs. § 1.401-1(b)(5). Rev. Rul. 69-494, 1969-2 C.B. 88, states that an investment will be consistent with the exclusive benefit requirement if the applicable investment satisfies the following requirements: (1) the cost must not exceed fair market value at time of purchase; (2) a fair return commensurate with the prevailing rate must be provided; (3) sufficient liquidity must be maintained by the trust to permit distribution in accordance with the terms of the plan; and (4) the safeguards and diversity that a prudent investor would adhere to must be present.

I hope this information is helpful to you. This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. If you desire to submit a request for a letter ruling, the procedures for filing a letter ruling request and a schedule of applicable user fees under the jurisdiction of the IRS Associate Offices of Chief Counsel are set forth in Appendix A of Revenue Procedure 2020-1, 2020-1 I.R.B. 1 (updated annually). Paragraph (A)(4) of Appendix A of Revenue Procedure 2020-1 sets forth a schedule of reduced user fees for a request for a letter ruling that applies under certain circumstances.

We appreciate your sharing your thoughts regarding investments in small business pension plans and Keogh plans.

If you have any questions about this letter, please call _____ at _____

Sincerely,

Joyce Kahn
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(Employee Benefits, Exempt Organizations,
and Employment Taxes)